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VIA ELECTRONIC MAIL (rule-comments@sec.gov)

May 31, 2011

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

RE: File No. SR-FINRA-2011-18; Proposed rule consolidation related to Investment Company Securities; SEC Release No. 34-64386.

Dear Ms. Murphy:

Charles Schwab & Co, Inc. ("Schwab") appreciates the opportunity to provide comment to the Securities Exchange Commission ("Commission") on proposed FINRA Rule 2341 ("Proposed Rule"),[1] which would replace NASD Rule 2830 in the consolidated Financial Industry Regulatory Authority, Inc. ("FINRA") rulebook.

Schwab commends FINRA for making significant improvements to the rule as originally proposed in 2009 ("Original Proposed Rule"). Specifically, Schwab applauds the modifications to the cash compensation provision that provide investors with access to layered disclosures that take advantage of available technologies. Schwab also appreciates that FINRA has drafted the Proposed Rule in a manner that allows FINRA member firms ("member firms" or "members") flexibility in presenting these narrative disclosures to investors.

While Schwab appreciates the changes that FINRA has made to the Original Proposed Rule, Schwab wishes to reiterate its comments on the Original Proposed Rule that adopting the Proposed Rule ahead of the Commission's more holistic review of investor protection initiatives—particularly conflict of interest disclosures—is premature and may lead to duplicative or contradictory disclosures for investors, as well as potentially conflicting compliance requirements and unnecessary corresponding increased costs for FINRA member firms.[2] Schwab believes that revisions to NASD Rule 2830 should be coordinated with other reforms the Commission determines necessary for the protection of investors, as well as any conflict of interest disclosures under consideration by FINRA.[3]

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[1] Notice of Filing of Proposed Rule Change and Amendment No. 1 to Adopt NASD Rule 2830 as FINRA Rule 2341 (Investment Company Securities) in the Consolidated FINRA Rulebook, 76 Fed. Reg. 26,779 (published May 9, 2011) (hereinafter "*Filing Notice*")

[2] *See, e.g.*, Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. Law 111-203, §919 (2010) (hereinafter "*Dodd-Frank*") (clarifying the Commission's authority to issue rules requiring investor disclosures at the point of sale).

[3] *See, e.g.*, FINRA Regulatory Notice 10-54.

Furthermore, it does not appear FINRA has demonstrated that the Proposed Rule in its current form (and without further clarifying revisions) is consistent with the requirements of the Securities Exchange Act of 1934 (the "Act"). Therefore, and for the reasons discussed below, Schwab requests that the Commission ask for FINRA's response to comments and clarifying revisions prior to approving the Proposed Rule.[4]

I. The Proposed Rule is premature and potentially duplicative of Commission investor protection proposals.

As an initial matter, Schwab believes that the Proposed Rule is premature given the significant investor protection initiatives currently underway or soon to be undertaken by the Commission over the coming months and into 2012. For example, under Dodd-Frank Section 913(l), the Commission has been directed by Congress to "(1) facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers and investment advisers, including any material conflicts of interest; and (2) examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers and investment advisers that the Commission deems contrary to the public interest and the protection of investors."[5]

If the Commission or FINRA move forward with new broad-based investor protection initiatives following approval and implementation of the Proposed Rule, investors may receive duplicative or even contradictory disclosures that have the potential to confuse investors, which is contrary to FINRA's objective and the purpose of the Proposed Rule. In addition, FINRA member firms could bear significant costs of complying with the various disclosure regimes, and investors ultimately will bear the increased compliance costs over time. Therefore, the disclosure regimes should be harmonized to provide the most effective disclosure and compliance regime, and to make the best use of available resources while minimizing the costs to investors.[6]

II. FINRA has not demonstrated that adoption of the Proposed Rule would be consistent with the requirements of the Securities Exchange Act of 1934.

Section 15A(b)(9) of the Act requires that the rules of a self-regulatory organization impose only those burdens on competition necessary to further the purpose of the Act. FINRA states in the Filing Notice that it "does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act,"[7] however,

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[4] The Commission could ask FINRA to republish the Proposed Rule for comment and allow member firms more time than the current 21-day period to comment on the significantly modified proposal. The Proposed Rule represents a significant departure from the current disclosure requirements of NASD Rule 2830.

[5] Dodd-Frank, at § 913(l). *See also* Dodd-Frank at § 917 (instructing the Commission to conduct a financial literacy study to determine methods to improve disclosures to investors, with a specific reference to improving transparency of expenses and conflicts of interest related to open-end investment company securities) and Dodd-Frank at § 919 (clarifying the Commission's authority to issue rules that require broker-dealers to provide information to retail investors before purchasing an investment product or service.)

[6] In addition, Schwab does not believe that FINRA member firms or mutual fund securities in particular should be singled out for conflict of interest disclosures and believes that the Commission is best suited to craft a broad-based disclosure regime that does not unfairly target certain firms or products.

[7] Filing Notice, 76 Fed. Reg. at 26,784.

the Proposed Rule does not present a careful and deliberate weighing by FINRA of the perceived benefits to investors against the burden on competition.

Schwab does not believe FINRA has adequately considered the burdens on competition that will be imposed by the Proposed Rule. During the comment period for the Original Proposed Rule, several members raised burden on competition concerns which were largely dismissed by FINRA with little explanation. The Proposed Rule then modifies certain aspects of the Original Proposed Rule, which FINRA acknowledges "may impose some additional burdens on members."[8] Not only has FINRA not given member firms an opportunity to provide commentary on the additional burdens the Proposed Rule may impose on members, and to evaluate the potential burdens on competition they may raise, it again has not provided any evidence to demonstrate that it independently analyzed such burdens in modifying the Proposed Rule prior to sending it to the Commission for approval.

FINRA states that the benefits to investors justify the adoption of the Proposed Rule because the Proposed Rule will provide greater transparency as to the potential conflicts of interest that can arise from arrangements related to the sale and distribution of shares of a mutual fund.[9] However, some firms deal with those potential conflicts of interest by leveling compensation their representatives may receive when recommending a mutual fund, regardless of the compensation the firm may receive. Moreover, implementation of the Proposed Rule as written likely will make it difficult for an investor to compare the potential incentives and conflicts. Some of the information will be in the prospectus, while some of the information—which may be duplicative of the prospectus disclosures—will be on the member firm's website. An investor may not understand that he or she needs to consult multiple sources to discern the totality of compensation that may be paid to a member firm, and even then, likely will not understand how—or even if—that compensation influences the offer or recommendation of mutual fund securities.

Investors also may be confused by the distinction FINRA has drawn between "sales charges" and "service fees" disclosed in the prospectus fee table, on the one hand, and "additional cash compensation" on the other hand, and the types of conflicts presented by the receipt of certain types of compensation. For example, FINRA clarifies that the receipt of sub-administrative and sub-transfer agency fees, even if received in exchange for services provided by the member firm, is required to be disclosed by the member firm pursuant to the Proposed Rule.[10] Investors will have a great deal of difficulty unraveling this web of disclosures to make sense of any potential conflicts presented.

Further, because of the difficulty member firms may have in determining whether a payment is "additional cash compensation" under the Proposed Rule (i.e., made from a source other than a "sales charge" or "service fee"), many member firms may default to disclosing *all* payments received, regardless of the source of the payment, while others that receive payments solely from a "sales charge" will not have to make available any disclosures even if such a sales charge is paid directly to the broker making the recommendation.[11] While Schwab appreciates the flexibility the Proposed Rule

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[8] *Id.* It is unclear if FINRA is referencing the Original Proposed Rule or the Proposed Rule in this statement.

[9] *Id.*

[10] *Id.* at 26,785.

[11] *Id.* at 26,784. In response to Schwab's comments on the difficulty of identifying of a "sales charge" or "service fee" disclosed in the prospectus fee table, FINRA states: "FINRA disagrees. The sales charge and service fees amounts that are paid to members must be clearly disclosed in an investment company prospectus.

offers, this will make it difficult for an investor to make an "apples to apples" comparison of potential conflicts across member firms.[12]

Because it does not appear that FINRA has adequately weighed the burdens on competition against the perceived benefits of the Proposed Rule, Schwab believes that the adoption of the Proposed Rule may not be consistent with the Act.

III. If the Commission grants approval of the Proposed Rule, Schwab believes the following provisions should be revised.

A. Disclosure of cash compensation paid by or on behalf of a particular fund family will satisfy the requirement of payments made by an "offeror".

The Proposed Rule would require that a member firm provide a narrative description on a web page or through a toll-free number of "additional cash compensation received from offerors" as well as a list of the "offerors" that have paid this additional cash compensation to the member firm. Under the Proposed Rule, "offeror" is broadly defined to include not only the fund company itself (i.e., payments made from fund assets), but also the fund's advisor, its administrator, underwriter, or any other affiliate of these entities. The names of which "offerors" pay additional cash compensation would be nearly impossible for many member firms to determine, and even if a member firm could discern the source of the compensation, such disclosures at an "offeror" level likely would be confusing to investors.

In addition, a requirement to list all "offerors" might result in member firms being forced to provide individual fund disclosures. The same fund family may adopt different fee structures across share classes or between funds, and different "offerors" may pay various portions of the fees depending on an individual fund's fee structure. Schwab believes that any such individual fund compensation disclosure would raise significant anti-competitive concerns. First, such fund-level disclosure would severely impact a member firm's ability to negotiate the rates of shareholder services received from the funds, and create a barrier to competition. Second, such arrangements between a member firm and a mutual fund are confidential and disclosure of such information would interfere with those contractual relations and result in diminished competition for shareholder and other services to the detriment of investors.

Schwab requests that the language in Section (l)(4)(C)(iii) of the Proposed Rule be revised to require disclosure of the name of the "investment company" that has paid or on whose behalf an offeror has paid (or entered into an arrangement to pay) compensation to the member firm, rather than requiring disclosure of the name of each "offeror" that paid the additional cash compensation.

B. Schwab requests the Proposed Rule be revised to permit a quarterly update of the narrative description on the member firm web page or through toll-free number to reflect new arrangements between a member firm and a fund company.

... If a member that is uncertain as to the character of the payments it is or will be receiving, it should err on the side of disclosing the receipt or expected receipt of these payments."

[12] For example, a member firm that receives a sales charge of 0.75% would not be required to provide any disclosures, whereas a firm that receives a shareholder service fee of 0.35% derived from any number of sources, including a 0.25% service fee disclosed in the fund prospectus fee table, may elect to disclose the entire amount and not just the "additional" 0.10% that is paid from sources other than a sales charge or service fee due to the difficulty the firm will have identifying which portion is paid from sources disclosed in the prospectus fee table.

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The Proposed Rule would require that the narrative description and names of firms that have paid compensation to the member firm discussed above be updated annually, or "promptly" in the event the information becomes "materially inaccurate" between annual updates. Schwab and other member firms are constantly entering into new contractual arrangements with fund companies under which some form of compensation may be paid. Schwab believes that it would be reasonable to require updates of the disclosures on a quarterly basis, and therefore requests that the language in Section (l)(4)(D) of the Proposed Rule be revised to replace "promptly" with "no less frequently than quarterly" to reflect new arrangements entered into between the member firm and a fund company during the prior quarter.

C. Schwab requests that FINRA modify the language of the Proposed Rule to require that disclosures related to any "preferred list" appear on the list itself, and to remove the requirement that such disclosures be separately made available on a web page or by toll-free number.

The Proposed Rule would require a narrative description of any "preferred list" of mutual funds to be recommended to customers that has been adopted "as the result" of the receipt of additional cash compensation, including the names of such mutual funds. Provided that the list is made available to clients, Schwab requests that the language of Section (l)(4)(C)(ii) of the Proposed Rule be revised to allow narrative disclosures related to a preferred list be published on the list itself rather than set apart in a standalone web page or through toll-free number. This placement would improve an investor's understanding of the possible connection between compensation paid to a member firm and the selection of a fund for the preferred list, if any.

IV. Implementation Date

Schwab reiterates the necessity of setting an implementation date of no less than 180 days following the Proposed Rule's approval. Member firms will need to gather a significant amount of information related to compensation arrangements for the prior calendar year, prepare notices to customers, update or create website disclosures, and train staff in responding to questions. This will be a significant undertaking for many member firms and appropriate consideration should be given to the considerable effort this will require.

V. Conclusion

Schwab thanks the Staff for consideration of the points raised in this letter and welcomes any further discussions or questions. Please feel free to contact me at (415) 667-0866.

Sincerely,

Bari Havlik

Bari Havlik
SVP and Chief Compliance Officer
Charles Schwab & Co., Inc.